

VZCZCXRO8858
PP RUEHCD RUEHGD RUEHHO RUEHMC RUEHNG RUEHNL RUEHRD RUEHRS RUEHTM
DE RUEHME #0063/01 0101343
ZNR UUUUU ZZH
P 101343Z JAN 08
FM AMEMBASSY MEXICO
TO RUEHC/SECSTATE WASHDC PRIORITY 0088
INFO RUEHXC/ALL US CONSULATES IN MEXICO COLLECTIVE
RHEHNSC/NSC WASHDC
RHMFIUU/CDR USSOUTHCOM MIAMI FL
RHMFIUU/CDR USNORTHCOM
RUEHC/DEPT OF LABOR WASHDC
RUCPDO/DEPT OF COMMERCE WASHDC
RHMFIUU/DEPT OF ENERGY WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS SECTION 01 OF 03 MEXICO 000063

SIPDIS

SENSITIVE
SIPDIS

STATE FOR A/S SHANNON
STATE FOR WHA/MEX, WHA/EPSC, EB/IFD/OMA, AND DRL/AWH
STATE FOR EB/ESC MCMANUS AND IZZO
USDOC FOR 4320/ITA/MAC/WH/ONAFITA/GERI WORD
USDOC FOR ITS/TD/ENERGY DIVISION
TREASURY FOR IA (ALICE FAIBISHENKO, ANNA JEWEL)
TREASURY FOR IA (ALICE FAIBISHENKO)
DOE FOR INTL AFFAIRS KDEUTSCH, ALOCKWOOD, AND GWARD
NSC FOR RICHARD MILES, DAN FISK
EXIM FOR MICHELE WILKINS
STATE PASS TO USTR (EISSENSTAT/MELLE)
STATE PASS TO FEDERAL RESERVE (ANDREA RAFFO)

E.O. 12958: N/A
TAGS: [ECON](#) [ELAB](#) [EFIN](#) [PINR](#) [PGOV](#) [MX](#)
SUBJECT: INFLATION A KEY CHALLENGE FOR THE MEXICAN
GOVERNMENT IN 2008

REF: A. 07 MEXICO 5242

[1](#)B. 07 MEXICO 391
[1](#)C. MEXICO 13

Summary and Introduction

[1](#)1. (SBU) A key challenge for the Calderon administration this year will be containing inflation expectations and bringing the overall inflation rate closer to 3%. The annual consumer price inflation rate hovered around the top end of the government's target range throughout 2007, with end-of-month annual rates exceeding 4.0% four times during the year. Headline inflation closed 2007 at 3.76%, but core inflation jumped to 4.00%. Mexico will face some new sources of inflation in 2008, including a new corporate tax and a gas tax hike, both of which went into effect this month. The government is trying to keep these taxes and general concerns about high food prices from becoming generalized. Calderon cut highway tolls, convinced retailers to sell basic food products at a discount in the first quarter of 2008, and cut industrial power rates by up to 30 percent. While these measures are not the most effective tools for dealing with inflation, Calderon probably wants to be seen as doing something to ease inflationary pressures to counter any potential political heat that would result from a generalized increase in prices. End Summary.

Headline Inflation Slows in December

[1](#)2. (U) The National Consumer Price Index rose a slightly more-than-expected 0.41% in December. This figure brought the annual inflation rate to 3.76%, within the Bank of

Mexico's (BOM) inflation target of 3%, plus or minus one percentage point. The yearend rate is down from 4.05% at the end of 2006, and is the second lowest since Mexico began tracking inflation in 1973. The BOM said that higher prices for tourism packages, tomatoes, limes, and eggs boosted inflation in December, while prices for local telephone service and a number of fruits and vegetables dropped. The overall inflation rate slowed, but core inflation jumped 0.46% in December -- bringing the 12-month rate to 4.00%, the highest reading since 2002, fueled by higher costs for tourism services, snack bars, and air transport. According to a BOM survey from December, market expectations for 2008 overall and core inflation are 3.86% and 3.67%, respectively.

Inflationary Pressures To Continue in 2008

¶3. (SBU) In addition to high prices for some foodstuffs, Mexico will have to deal with new sources of inflation in ¶2008. Specifically, the 5.5% gasoline and fuel tax increase that was approved as part of the 2007 fiscal reform went into effect on January 5. While its effect on inflation should be limited because the tax hike will be implemented over an 18-month period, some observers have argued that it will be used as an excuse to increase public transportation rates and have noted that, in the past, producers and retailers have used higher gasoline prices to justify other price hikes. The Single Rate Corporate Tax (IETU) also went into effect this month, and economists are unsure how the new tax will affect firms' pricing strategies. Moreover, some tortilla producers are threatening to hike prices nationwide. Local press reports say tortillas prices increased to 11.50 pesos/kg in some states, from a previous 8 pesos. While some

MEXICO 00000063 002 OF 003

observers argue that the price increases probably will be short lived, these reports are worth monitoring since tortillas are a staple in the Mexican diet and an important component of the CPI. Moreover, last January the government faced harsh criticism when tortilla prices spiked (Ref B).

Government Trying To Anchor Inflation Expectations

¶4. (U) In a speech from his residence on January 7, President Calderon pledged that his government would watch closely the behavior of prices and that it would act firmly to avoid unjustified price hikes that could affect households. Calderon added that despite high prices for various commodities, Mexico posted one of the lowest inflation rates in the country's history last year.

¶5. (SBU) The Calderon administration has announced a number of measures aimed at containing inflation expectations, given that such expectations greatly influence actual inflation. Calderon on January 7 issued a decree that permanently reduced peak electricity tariffs for industrial use by up to 30 percent. (Note: the electricity sector in Mexico is state run. End Note.) The power-rate-adjustment will cost 7.8 billion pesos (\$716 million), an expense that was planned for in the 2008 federal budget. He also announced that the government will not adjust federally administered toll road fees for inflation in 2008, and that it will discount fees on several other toll roads through yearend. The administration also convinced retailers to sell a number of household goods that weigh heavily in the consumption basket of low-income households at a discount in the first quarter of 2008.

¶6. (SBU) In addition to the above measures, in late December the GOM announced the country's new negotiated minimum wage for 2008 with an eye toward fighting inflation. The new daily minimum wage, which took effect on January 1, 2008, increased 4% over 2007 from 48.67 pesos to 52.59 pesos. The 4% increase was considerably less than the 10% raise sought

by Mexico's organized labor unions. However, since the minimum wage is used throughout Mexico as a standard of reference for such things as job salary offers, private service fees, government fines, tax tables, and a broad range of other financial indicators, the GOM ultimately sided with the private sector in wage negotiations on the need for a small increase as a way to hold down inflation (Ref C).

Comment

17. (SBU) The Calderon government undoubtedly wants to avoid a repeat of last January, when it took political heat from ballooning tortilla prices. While the measures he has announced to date are not the most effective tools for dealing with inflation, Calderon probably wants to be seen as doing something to ease inflationary pressures -- especially since the negative effects of inflation tend to disproportionately hit poorer households. While anything that worsens the situation of Mexico's large poor population (roughly 40%) is bad unto itself, this also would give the left fodder to criticize Calderon. Another important reason for keeping inflation low is that the central bank would be under pressure to hike interest rates if inflation rises -- something that would work against the Mexican economy's ability to continue growing in the face of an economic slowdown in the U.S.

MEXICO 00000063 003 OF 003

Visit Mexico City's Classified Web Site at
<http://www.state.sgov.gov/p/wha/mexicocity> and the North American
Partnership Blog at <http://www.intelink.gov/communities/state/nap/> /
GARZA